

## The Phenomenon of Capital Flight in Third World Countries: Evidence From Selected Oil Firms in Nigeria

Iyeli, I. Iyeli, Ph.D<sup>1</sup>, Ayadu, E. Kofie<sup>2</sup>

<sup>1</sup>Department of Economics, University of Calabar

<sup>2</sup>Federal Inland Revenue Service Port Harcourt - Nigeria

Accepted 1<sup>st</sup> August, 2016.

### Abstract

This paper on the phenomenon of capital flight in the Nigerian economy, investigate how the financial resources of the economy are constantly transferred out to foreign economies. The research probes into the financial operation of multinational oil companies and their contribution to the general growth of the Nigerian economy. This research became quite necessary on grounds that Nigeria being the 9th largest producers of crude oil with billions of dollars in foreign earnings is classified among the poorest countries of the world. This study is descriptive and empirical in nature and is carried out on some selected oil firms. Tables, charts, and percentage are used to analyze the financial data obtained from both primary and secondary sources. Descriptive tools are preferred to inferential tools given the nature of the problem being investigated. The research has led to the discovery of the fact that 82% of the total wealth created from the Nigerian oil sector is paid into foreign accounts while only 18% is paid within the domestic economy. This 82% of the total wealth created within the economy constitute capital flight from the economy. To reverse this trend, the government needs to reappraise its market-driven economic policies to reflect the realities on the ground. Multinational oil companies should be made to realize the need to retain some of their wealth within the economy.

**Keywords:** Capital flight, Third world countries, multinational oil companies, misinvoicing, overinvoicing, underinvoicing.

### INTRODUCTION

The state of the Nigerian economy has been a source of concern to both the government and the citizens. It has, in general, been declining, particularly since the early 1980's, and measures designed to arrest the situation have been ineffective. Several factors have been suggested as the explanations for the declining state of the economy. They include the mono-product (oil) nature of the economy, over-dependence on foreign inputs and technologies, inefficient foreign exchange market management, foreign debt crisis, capital flight phenomenon, poor economic mismanagement and corruption, weak industrial base, weak and declining value of the Naira and total neglect of the agricultural sub-sector of the economy. Of these, analysts tend to argue that the most damaging is capital flight. According to Salisu (2005), Capital flight weakens the domestic currency by transferring the much needed foreign exchange in the domestic economy to a more advanced foreign economy. Ajayi, (1997) attributed the debt crisis problem in Nigeria to the phenomenon of capital flight, and link declining terms of trade in Nigeria to capital flight

menace. Cuddington (1986) also established a positive relationship between exchange rate misalignment and capital flight.

To be able to assess the nature and impact of the problem and to guide public policies, we need some facts, and the way to produce the facts is to conduct specific studies. It is our desire to contribute in this direction that has induced us in this study. In order to be able to examine effectively the phenomenon of Capital flight, the following research questions are hereby formulated: What are the dimensions of the phenomenon of Capital Flight? In what specific ways Capital flight take place? What are the factors behind the phenomenon? In what specific ways can the government minimize the problem of Capital flight?

Therefore, the main objective of the paper is to investigate the nature of the problem of capital flight in Nigeria. Specifically, the paper will provide answers to the questions raised. Through, investigating the activities that create

conditions for capital flight; examining the specific ways in which capital flight takes place

The paper is divided into five sections; following this introduction, section 2 deals with literature review. Section 3 is concerned with the analysis of capital flight and the Nigerian economy, while Section 4 is the methodology of the study. Section 5 contains the summary of findings and concluding remarks.

## LITERATURE REVIEW

### *Conceptual Issues*

Discussions of capital flight are characterized by controversies. There are debates about the definition, and there are debates about the measurement. We attempt to outline some of the ideas in this section.

Capital flight connotes illegal movement of capital from one country to another. This connotation implies that there may be "normal" or "legal" and "abnormal" or "illegal" flows. Normal capital flows are those which are not sanctioned by the government. The question of the illegality of capital flows then implies that the country in question imposes capital controls (Nyong, 2005).

However, Lessard and Williamson (1987) define Capital flight as capital that "runs away" or "flees" abnormal risk at home regardless of whether or not the flight is legal.

According to Ajayi (1997), capital flight can, therefore be defined as the acquisition or retention of claims by non-resident, motivated by the owner's concern, that the value of his claims continue to be held domestically. In other words, it is essentially non-market risk involved that distinguishes capital flight from capital outflow; the risks associated with political instability in particular. Outflows from developed countries are called foreign investment, while outflows from developing countries (the same activity) are called capital flight. Investors from developed countries are seen to be responding to investment opportunities while investors from developing countries are said to be escaping the high risk they perceive at home.

Schneller (1997) defines capital flight as "international capital movements which respond to heightened domestic, economic and political uncertainty. Capital flight response to the degree of domestic macroeconomic mismanagement postulated to generate a domestically un-diversifiable risk that can significantly reduce returns to investment.

Dooley (1986) views capital flight as the accumulation of claims of non-resident that are not subject to taxation, regulation, or, in extreme circumstances, confiscation by the domestic government.

From a completely different point of view, some economists define capital flight "as the ready acceptance of fugitive money deposited by rich individuals and firms in the same banks that hold claims on the countries of origin presenting a particularly ironic twist to debt crisis"

For the purpose of this study, we consider (Nyong, 2005) view of capital flight as the de-capitalization of the economy where productive financial resources are transferred from the domestic economy to advanced western economies be it legal or illegal.

The reason for using this controversial term "capital flight" is to show the extent of damage that capital outflow does to the domestic economy. If the negative impact is small, the term capital outflow is applicable; otherwise, capital flight is the preferred alternative if the negative impact is substantially heavy.

Several researchers have attempted to investigate the problem of capital flight. They include Ajayi (1992), Harberson and Roychild (2000), Alan Shapiro (1992), Salisu (2005), Manuel Pastor (1990), etc. Capital flight is caused by political factors, macroeconomic mismanagement and policy distortions that serve as incentives for residents to take their assets out of the country. The economic mismanagement in the form of expansive fiscal and monetary policies and exchange rate overvaluation, create uncertainty and make the domestic environment unattractive for investment, while exchange rate overvaluation creates conditions for expected devaluation, residents in such situations usually have no confidence in announced policies to deal with the economic problem, preferring instead to take their assets out of the country. These economic factors include declining terms of trade, exchange rate overvaluation, fiscal deficit, financial repression and constraints, and increasing the foreign real interest rate. Non-economic factors are the corruption of political leaders and lack of accountability (Ajayi, 1992).

Declining terms of trade is one of the major causes of capital flight. Declining terms of trade lead to a contraction in economic activities. These occur when there is a reduction in investment, exchange rate overvaluation and thus the fears of expected devaluation. Consequently, macroeconomic disequilibrium emerges, which is manifested in the balance of payments problems, fiscal deficit, and decline of investments. These usually forces the government to exchange its programme. Since declining terms of trade leads to a fall in government revenue, and government can no longer meet its obligations without an increase in taxes. As such, investors anticipated higher taxes, and therefore, they divert their investments abroad (Salisu, 2005).

Capital flight practices are encouraged as a result of exchange rate misalignment. Where the local currency is overvalued it leads to real exchange rate appreciation. In order to overcome the expected currency devaluation, investors usually move out their domestic assets and invest in foreign countries, to avoid capital loss from devaluation. The relationship between real exchange rate misalignment and capital flight has been empirically investigated. Cuddington (1986) study of some Latin American countries found in the case of Mexico of a positive relationship between exchange rate misalignment and capital flight. Ajayi (1992) found out that the degree of appreciation of the Nigerian Naira facilitated capital flight.

Capital flight can be attributed to the budget deficit. In order to finance the budget, the government usually prints money, a practice which is inflationary; if inflation persists, individuals will likely choose to reduce their real holding of domestic currency in order to protect themselves against the so-called inflation tax. Some of these reduced holdings will appear as capital flight (Pastor, 1990). In a related dimension when the fiscal deficit is financed through bond sales, domestic residents may expect that at some future date, their tax base liability may increase in order to pay for the national debt. This would encourage domestic investors to move their assets to foreign countries to avoid potential tax liability (Ajayi, 1992).

Capital flight can also be linked to financial repression and constraint. In most developing countries, prior to the financial sector reform, interest rates were administratively determined, and this set returns to investments below the market determined rate. The general restrictions on the proper functioning of the financial system led to low financial intermediation in the domestic economy and also encourages the outflow of capital to more lucrative markets. These markets have limited instruments in which investors can invest.

Capital flight can also be traceable to excess foreign borrowing. In most countries where there is huge debt acquisition, there is also increased the outflow of capital in the form of capital flight. Since the developing countries suffer from foreign exchange constraints, capital is needed to finance imports, and this is usually sourced from external sources. However, no sooner small amounts of foreign exchange trickled in, then a large part sets off on the return journey back to banks in donor countries without being used in any way for domestic production (Duwendy, 1989). Such two-way flow leads to round tripping in which the publicly contracted loans eventually found their way back to foreign countries in the private bank account of some citizen of developing countries.

Shapiro (1992) stressed that "capital flight is the export of saving by a nation's citizen because of fear about the safety of their capital". He held the view that one good indicator of the degree of political risk of a country is the seriousness of capital flight.

On the causes of capital flight, he argued that several reasons, most of which have to do with inappropriate economic policies like government regulations, financial controls, and taxes are responsible for low returns on domestic investments. He demonstrated that countries where inflation is high and domestic inflation hedging is difficult to control, investors may hedge by shifting their savings to foreign countries they deem less likely to depreciate. They may also make the shift when domestic interest rates are artificially held down by the government, or when, they expect a devaluation of an overvalued currency.

In his view, to halt capital flight required "tough-minded" economic policies to be put in place such as cutting the budget deficit and taxes, removing barriers by government to foreigners, selling off state-owned enterprises, allowing for free trade, and avoiding currency overvaluation that virtually invite people to ship their money elsewhere before the official exchange rate drops (Shapiro, 1992).

Unlike the speculation of proper capital flight, it is initiated not with the hope to gain but the fear of loss (Salisu, 2005). When a country faces the prospect of exchange depreciation, the imposition of exchange control, political instability, or war, domestic and foreign residents who own assets in that country, do seek safety by transferring funds to a country that is considered stable. From the above statement, it can be inferred that Root's argument for capital transfer or movement (capital flight) is not for economic gains like interest rate accrual but solely for fear of loss.

The consequences of capital flight (Salisu's View) are that it weakens the domestic currency by transferring the much needed foreign exchange in the domestic economy to a "surplus foreign exchange" economy. By way of controlling capital flight, Root suggested that the foreign exchange control regime should be adopted that will regulate the acquisition and disposition of foreign exchange.

Other forms of direct control such as import quotas and import license should be applied. In his view, once exchange control is adopted to restrain capital flight it has to remain a permanent feature of a nation's foreign exchange policy at least for a reasonable length of time.

According to Harbeson and Roychild (2000) Capital Flight from Africa started many years (especially in the 60's and 70's) of increasingly imposing enormous difficulties for investors, such as political arbitrariness, spreading Civil War and other form of strife, and administrative, infrastructural, and economic inefficiency. World business leaders took an increasing jaundiced view of Africa. As one business executive put it, "who cares about Africa, it is not important to us; leave it to the

IMF and the World Bank". For most foreign investors, Africa had become a voracious sinkhole that swallowed their money with little or no long-run return. They highlighted two primary reasons for capital flight: official corruption and Macroeconomic mismanagement such as overvalued exchange rate resulting from capricious fiscal and monetary policies by African governments, punitive taxation levels, excessive regulation, and short sighted short-sighted controls on the financial sector scare away prospective investors, foreigners soon turned their attention to economies in other regions of the world that are more hospitable to their investments. Whereas African capital soon found ways to escape financial controls and make its way into European banks and their low-risk dividends.

External factors such as rising foreign real interest rate, economic stability and diversified investment opportunities all contribute to attracting capital from developing countries. Rising foreign real interest rate facilitates capital flight by changing the relative returns on an investment, as foreign real interest rates rises, public sector foreign liability increase. Also, private sector liability increases as national outputs fall. Most residents who expect an increase in taxes divert their investment abroad. In addition to that, in some of these countries, secret bank accounts are permitted. People from developing countries put their money there, where it is considered safe since their governments cannot have access to the accounts held abroad (Ajayi, 1992).

In terms of non-economic causes, some political office holders in developing countries usually abuse their offices. They use their position in government to demand kickbacks from government contractors. In some cases, they simply embezzle government funds at their disposal. Since such funds are acquired illegally it is usually kept abroad. It is now obvious that the private wealth of some African dictators is equivalent to the external debt of their countries. Also, the existence of political instability easily proxied by a frequent coup and counter-coups which create uncertainty and insecurity have been identified as one of the non-economic causes of capital flight (Awung, 1995).

## MEASURES OF CAPITAL FLIGHT

According to Hermes, Lensink and Murinde (2002), the measurement of capital flight is not straightforward, given that there is no consensus on the definition of capital flight. Ajayi (1992) states that, by its very nature, it is difficult to measure capital flight, however, a number of capital flight estimates have been made over the last several years.

According to Ajayi (1992), most significant of these studies which have made impact on capital flight estimates include: the studies by Dooley (1986, 1988), Dooley et al (1986), World Bank (1985), Morgan Guaranty Trust Company (1987), Salisu (2005), Cuddington (1986), Cumby and Levic (1987), Gulati (1987), Lessard and Williamson (1987), Khan and Ul Haque (1987), Obadan (2004), Khan (1989). The World Bank (1985) study covered Argentina, Brazil, Mexico, Portugal, South Korea, Turkey, Uruguay, and Venezuela.

According to Nyong (2005), in the light of the difficulties, we will not attempt to distinguish "normal" from "abnormal" capital outflows; rather we will concentrate on measuring resident capital outflow. In his work on a capital flight from Nigeria, Nyong (2005) outlined four main approaches to the measurement of capital flight, namely; the balance of payments accounts approach, the residual approach, the bank deposits approach and the sources and uses approach.

According to Hermes, Lensink and Murinde (2002), in line with World Bank (1985) and Erbe (1985), the following measures of capital flight are distinguished in the literature:

#### *i. The Residual (Broad) Method:*

This method measures capital flight indirectly by comparing the sources of capital inflows (i.e. Not increases in external debt inflows (i.e., the current account deficit and additions to foreign reserves).

According to Hermes, Lensink and Murinde (2002), the residual method acknowledges the difficulties of separating, abnormal from normal capital as being capital flight.

According to the residual method, capital flight is calculated as follows:  $Kf = ED + FI - CAD - \Delta FR$ , where: KF is capital flight, according to the residual method,  $\Delta$  denotes change, ED is stock of gross external debt reported to the World Bank data, FI is the net foreign investment inflows, CAD is the current account deficit and FR is the stock of official reserves.

#### *ii. The Dooley Method*

According to Hermes et al., (2002), this method aims at distinguishing normal from abnormal or illegal capital flow. Dooley (1986) as cited by Hermes et al., (2002), sees capital flight\*as the total amount of externally held assets of the private sector that do not generate income recorded in the balance of payments statistics of a country. Or stated otherwise, capital flight is all capital outflows based on the desire to place wealth beyond the control of the domestic authorities. The differences between total capital outflow and the change in the stock of external debt assets corresponding to reported interest income is measured as capital flight.

According to Dooley method, capital flight is measured as follows. First, the amount of the total capital outflows is calculated;

$$TKO = FB + FDI CAD - DFR - EO - WBIMF$$

where TKO is total capital outflows, FB is foreign borrowing as reported in the balance of payments statistics, EO is net errors and omissions (debit entry), and WBIMF is the difference between the change in the stock of external debt exported by the World Bank foreign borrowing reported in the balance of payments statistics published by the IMF. The stock of external assets corresponding to reported interest earning is:  $ES = INTEAR/rus$

Where ES is external assets, r is the US deposit rate (assumed to be representative international market interest rate), and INTEAR reports interest earnings.

Capital flight according to the Dooley method is then measured as  $KFd = TKO - DES$ .

The Dooley method is conceptually different from the residual method.

However, Claessens and Naude (1993) as cited by Hermes et al., (2002), show that in practice capital flight measured according to the Dooley method and the residual method are fairly similar, since most of the data used for the calculation are the same in both cases.

#### *iii. The Hot Money Method:*

According to this method, capital flight is measured by adding up net errors and omissions and non-Bank private short-term capital outflow. Like the Dooley method, this method corresponds to the idea that capital flight goes unrecorded due

to the illegal nature of these capital movements. The unrecorded capital movements are believed to appear in net errors and omissions. Moreover, by concentrating on short-term flows, medium and long-term outflows are excluded, which are viewed as being normal in character according to Gibson and Taskalotos and cited by Hermes et al (2002).

Thus, the hot money method (KF) can be calculated as follows:  $KF = SKO + EO$

Where SKO is the total amount of short-term capital outflows and EO = Errors and Omissions.

#### *iv. The Trade Mis-Invoicing Method:*

According to Hermes et al., (2002) trade mis-invoicing is determined by comparing trade data from both the importing and exporting country. Importers are assumed to be involved in capital flight when they report the higher value of imported goods as compared to the reported value of the same goods by exporters.

In turn, exporters are involved in capital flight when they report lower values of exported goods as compared to the reported value of the same goods by importers. Proponents of this measure stress the fact that abnormal capital outflows of residents may be included in export under-invoicing and/or import over-invoicing since both these malpractices provide channels to siphon domestically accumulated wealth outside the country.

In some cases, those authors using the residual method argued that the measurement of capital flight in this way is inaccurate due to the poor quality of export and import figures resulting from trade mis-invoicing. Therefore, they proposed to adjust capital flight figures based on the residual method. (Hermes et al, 2002).

#### *v. The Asset Method*

According to Hermes et al (2002), some authors take the total stock assets of non-bank residents held in foreign banks as a measure of capital flight. The asset method is a short term measure of capital flight. This measure may be seen as an indication of the minimum amount of asset held abroad, since residents may hold their assets in other forms next to bank accounts, for example, in foreign equity holdings. The IMF provided data on these bank assets until 1994. For recent years, however, no information is available to apply this measure (Hermes et al., 2002).

### **Capital Flight and the Nigerian Economy**

The capital flight had been identified as one of the major factors for the backward nature of most developing economies including Nigeria. The drain on productive resources from the Nigerian economy has gone beyond money capital flight to include intellectual capital flight. The distinction of the "flight of intellectual" is a brain drain. Intellectual flight is the migration of writers, scientists and experts from Nigeria to wealthier nations. The intellectual capital flight also is about the migration of intellectual materials that can be used to develop knowledge, experience, and intellectual property. For instance, the westernization of African music is a flight of intellectual capital. Also, western music companies own the copyrights of most African music. The most productive African musicians now live and work in New York, London, and Paris. The music of King Sunny Ade, Kanda Bongo man, Yossou N'dour is created for the taste and consumption of westerners and is

gradually losing its original African authenticity (Emeagwali, 2001).

However, from whichever perspective this concept is viewed (i.e. money capital, intellectual or intellectual capital flights) one thing is common to all that is they all focus on the outward drain of productive resources (in one form or the other) from the domestic economy to advanced nations. For the purpose of this study, emphasis will be limited to the phenomenon of money capital flight as it affects the Nigerian economy.

The Nigerian economy is an oil-economy dominated by foreign multi-national companies in both upstream and downstream sub-sectors of the oil sector. The indigenization and local content of the Nigerian oil sector have been conspicuously low at about 5%. This, in essence implies foreign domination of the sector in terms of manpower and other relevant inputs. The high foreign input has its associated problem of transfer pricing and capital flight menace.

According to Gaius-Obaseki (2000), "the nation losses over N500 billion (US \$4.95 billion) yearly in capital flight by way of technical services and goods procured outside Nigeria when in some cases they can be sourced locally. He emphasized that "it is a source of concern for us to realize that about \$5.5 billion budgeted annually in the industry, over 90% (about \$4.95 billion) is spent on technical services and foreign inputs". This revelation confirms that over 90% of the annual budget in the sector constitute capital flight from the domestic system. Also note that the 90% is exclusive of privately budgeted expenditure, of multinational companies. Hence, if the capital flight component of their expenditure is added to the officially declared 90%, then it is obvious that capital flight from the system exceeds 90% of total budget in the sector.

In another perspective, Ethiopian-based UN Economic Commission for Africa (ECA), argued that "capital held by Africans overseas is equivalent to 39% of gross domestic product (GDP) compared with six percent for Asian countries. In relation to GDP, capital flight was estimated to be as high as 133% for Nigeria, 102% for Sudan and 58% for Kenya. Of the 18 countries surveyed by ECA in 1991, Nigeria topped the list with a capital flight/debt ratio of 94.5% followed by Rwanda with 94.3%. This constitutes a menace to Nigerian economy in particular and to Africa in general. Nigeria is believed to have 50 billion U.S. dollars alone outside the country, most of is, hot money".

The upstream sub-sector of the oil industry in Nigeria is made up of eight private foreign companies, which explore for and produce oil as joint Ventures Partners with the NNPC. The companies are Shell Petroleum Development Company of Nigeria Limited, Mobil Producing Nigerian Unlimited, Texaco Overseas (Nigeria) Petroleum Company Unlimited, Philips Nigeria Limited and Ashland Nigeria Limited.

Indigenous participation in oil exploration and mining is very insignificant. The Government is currently pursuing measures to ensure that indigenous companies are active as their foreign counterpart. Over 20 Nigerian companies have been licensed although only 5 are said to be operational. In 1993, the Nigerian Petroleum Development Company a subsidiary of NNPC engaged in oil production in a joint venture with British Gas Company, produced only 3,000 barrels per day while Dubril Oil Company Limited, a privately owned enterprise produced only 1,000 barrel per day. The two indigenous firms are producing at 0.4 percent of the total output.

The joint venture arrangements are administered through the Joint Operating Agreement (JOA) negotiated between the NNPC and the oil companies. Under this arrangement, the

host government through NNPC and the foreign operating oil companies contribute to the cost of operation and share crude oil output in the proportion of their equity shares. The contribution to the cost of operation by NNPC is called "cash calls".

- a) The Joint Operating Agreements (JOA) provide the following: Specifies the appointment of a multinational oil company as the operator of the venture and specifies the rights, powers, responsibility and obligations of the operator;
- b) Establishes an Operating Committee (OC) consisting of the representative of the government and the oil company, defining the addition the power and duties of the OC;
- c) Specifies the funding obligations of the parties;
- d) Specifies the power and the circumstances the parties can embark on sole risk operations; etc.

This JOA implies that the foreign operating companies are empowered to carry out the execution of the agreement by incurring costs on behalf of NNPC. Thus, the cost (liability) and the output (benefits) will be shared according to the percentage of equity ownership. This reveals that the entire cost of exploration and production is borne initially by the multinational companies before being shared with the NNPC as stipulated in the JOA. Reimbursement by NNPC to multinationals comes in the form of cash calls, which is the actual amount incurred by the multinational companies on behalf of the NNPC.

It is also pertinent to note that the Nigerian oil industry is divided into two broad categories: the upstream subsector which is concerned with the exploration, exploitation, transportation and sale of crude oil and natural gas; and downstream sub-sector is concerned with the processing of crude oil and natural gas into petroleum products. The downstream subsector oversees the four refineries built in the country with a total install capacity utilization of 445,000 barrels per day.

However, since the multinational companies execute the JOA, they are expected to ensure that the actual act of exploration and crude oil production are effected either directly by them or indirectly through contracts subletting to other multinationals (i.e. External to the agreement) or to their subsidiaries. It is at this point of execution and payment to the various contractors that capital flight takes place. For instance, foreign input requirement needed to keep the oil sector in Nigeria functional has led to a loss of over N500 billion (about US \$4.95 billion) annually to capital flight (Obaseki, 2001). Judging from the magnitude of the problem from the oil sector, it is evident that the summative effect across all sectors of the Nigerian economy that calls for attention.

Another obvious indicator of capital flight problem in Nigerian economy is the problem associated with trade misinvoicing. Trade misinvoicing emanate from falsification of a trade transaction. In practice, the official balance of payment (BOP) data on export and imports is often of poor quality due to trade misinvoicing. (Boyle and Ndikumana, 2001). By definition trade misinvoicing is the deliberate falsification of a trade transaction in order to take advantage of the difference. It is also referred to as "trade faking". Ajayi (1992) attributed capital flight from Nigerian oil sector to trade faking, thus, establishing links between capital flight, corruption, and government failure.

**Table 1:** Joint Venture Agreement

Shell P.D.C NNPC 50%,	SPDC 35%	ELF 10%,	AGIP 5%
Mobile	40%	NNPC	60%
Chevron	40%	NNPC	60%
Agip	20%	NNPC	60%
EIF	40%	NNPC	60%
TEXACO	20%	NNPC	60%
Pan Ocean	40%	NNPC	60%
Philips	20%	NNPC	60%
Chevron	20%	NNPC	60%

**Source:** NNPC School Enlightenment Lecture (2002)

**Table 2:** Oil Contracts and Payment Arrangements in selected Firms

S/ N	NAME OF COMPANY	CONTRACT NO	LOCAL/ CODE	CONTRACT WITH	A B CURRENCY SPLIT IN%		A B DESTINATION OF PAYMENT		AVERAGE
					FOREIGN CURR.	LOCAL CURR.	FOREIGN	LOCAL	
1.	SOWSCO WELL SERV.(NIG) LTD	DRL-1999-2110 DRL-1999-2110 DRL-1999-2110 DRL-1999-2110	AMAR "A" IHEOMA-2 ALAOMA-3 ALAOMA -2	CHEVRON NIG. LTD. CHEVRON NIG. LTD. CHEVRON NIG. LTD. CHEVRON NIG. LTD.	90% 90% 90% 90%	10% 10% 10% 10%	TEXAS, U.S.A TEXAS, U.S.A TEXAS, U.S.A TEXAS, U S A	P.H, NIG. PH.NIG. PH, NIG PH, NIG.	90% 20%
2.	DATALI NE PET. SER. NIG. LTD.	i. MPA#077 ii. ED/P-A MPA# 077	ASASAA, B & ETMC EDOP-A	MOBIL PROD NIH LTD MOBIL PROD. NIG LTD	80% 80%	20% 20%	TEXAS, U S A TEXAS, U.S.A	P.H NIG P.H NIG	80% 20%
3.	GEO-FLUID NIG. LTD	DR1/CO53/00	0B118-121	ELF	80%	20%	FRANCE	P.H, NIG	80% 20%
4.	GEO- SERVICES NIG. LTD.	i. REF. 59172 ii. 96309810 iii. NOVO148P/01 iv. PRO/CO38/96 v. EPNL/SC.64 vi. PRO/CO37/96 vii. 022-1095/19 viii. MPA#22A	AGBAR PLATFORM OBAMA 12DIR 061AFU-5 RNGA 118 SAIFEM 32 RNGA 0010, OBI 16 OML58 ADRIATICS, ENANG. OSO 17B, 25B ...	NAOC NAOC NAOC ELF ELF ELF MOBIL PROD UNLTD MOBIL PROD UNLTD	70% 95% 80% 80% 80% 70% 80% 70%	30% 5% 20% 20% 20% 30% 20% 30%	FRANCE FRANCE FRANCE FRANCE FRANCE FRANCE FRANCE FRANCE	P.H, NIG. P.H, NIG P.H, NIG P.H, NIG PH.NIG P.H, NIG P.H, NIG P.H, NIG	78% 22%

**Source:** Survey Data

**Table 3:** Currency Split of Each Firm

		Foreign (\$)	Local
1.	Sowsco Well Service	90%	10%
2.	Dataline Petrol Service	80%	20%
3.	Geofluid Nig. Ltd	80%	20%
4.	Geo-Service Nig. Ltd	78%	22%
	Averagely	82%	18%

Source: i) Derived from table 2

Trade misinvoicing is of two folds; falsification of import invoices and falsification of export invoices. Falsification of import invoices takes the form of transferred pricing where an importer overstate his invoices above what ought to be in order to take advantage of the net difference. This net difference constitutes a capital flight from the importing country. On the other hand, falsification of export invoices has attained an alarming position lately where the right exports value of Nigeria oil export is not known with certainty and is believed to be understated. Nigeria is estimated to have suffered more than US \$16 billion in export underinvoicing (Boyle and Ndikumana, 2001).

Nigeria had been indicted by various international studies to have fallen prey to this problem of overinvoicing of imports and underinvoicing of exports. On the average, imports to Nigeria are overinvoiced by more than 30%. In other words, for every dollar Nigeria spends on the importation of goods and services, more than 30% leave the economy as capital flight (Emeagwali, 2001). Then, the (failed) interaction between the taxation system of developed countries and the system of developing countries generates a very significant motive for capital flight by the residents of developing countries. Nigerian economy is badly affected in this regard since its tax system fail to capture enough revenue from foreign investments of its residents. This untaxed resource constitutes a capital flight from the system.

The straight roles of the oil sector and its overwhelming influence on Nigerian economy need to be guided jealously for the required impact to be felt. Despite this, it's staggering to note that the sector is dominated and controlled by foreign companies both in the exploring and servicing subsectors. According to Jackson Gaius Obaseki (Group Managing Director, Nigerian National Petroleum Corporation - NNPC), "over 40 years of the oil sector in Nigeria, indigenous participation and local content in the sector still all below 5 percent" (vanguard, 16th April, 2001).

This point to the fact that 95% of all functional companies in the sector are foreign companies with higher foreign input requirements in the form of human and non-human requirements. Most of these foreign companies are subsidiaries of Multinational Corporation with parent company overseas. For instance SBM Marine Nigeria Limited and Geo-services Nigeria Limited are subsidiaries of SBM Marine Limited Offshore and Geo-services S.A. with headquarters in France respectively.

### **Evidence of Capital Flight from the Oil Sector**

With this operational structure of parent company/subsidiary arrangement coupled with a strong foreign link between the parent companies and the oil prospecting companies overseas (that is ELF, Shell, Mobil, Chevron, Agip etc.) tend to promote the foreign skewed oil sector both in operation and in participation. This develops a nationalistic patronage such that American firms are highly preferred to transact with by Mobil Producing (being an American Company) while British firms are favored by Shell. In a situation like this, indigenous companies are misplaced in the scheme of things in the sector, thus paving the way for foreign domination. A typical example of this scenario is the multi-million dollars worth of contract sign between Elf and SBM Marine Limited Offshore in France on behalf of the SBM Marine Nigeria Limited. This arrangement places indigenous companies at a disadvantage. From this operational perspective of the oil sector in Nigeria, it is apparent to note that the system is capital flight driven because of high foreign perception and involvement in the sector, thus

promoting massive capital drainage from the domestic to foreign economies.

Secondly, apart from the foreign domination of the sector, it is also worthy to examine vividly the invoicing practice that most companies (if not all) in the oil sector are involved in; the practice of dual currency invoicing. This is an arrangement where an invoice tendered for services rendered are split into two parts: one part in foreign currency and the other in local currency. These splits in some cases are made mandatory for indigenous companies since they are expected to have foreign partners, hence the need for a foreign account. Among foreign companies dual currency invoicing is the general practice. Apart from the split currency being made mandatory for indigenous firms (mainly those involve in technical service), the percentages of the split currencies are in some cases made compulsory by the contracting company. The foreign currencies portion of these invoices mostly American dollars is paid directly into foreign accounts while the local portion is paid domestically. Table 2 is an outcome of the the investigation carried out on some selected oil companies to portray the above-stated view.

Table 2 is a tabular presentation of data obtained from the investigation carried out from some companies in Portharcourt, River State capital Column 1 contains the various companies upon which investigation was carried out. Column 2 shows the contract number for easy references into the various agreements entered and their terms of agreements. Column 3 shows the various location or oil wells/rigs upon which the agreements were based upon. Column 4 shows the prospecting companies. Column 5 is the currency column. It's in two parts; the foreign currency column and local currency column. This column shows the split between the local and foreign currencies expressed in percentages. The foreign currency column has entries between the ranges of 70

- 95 percent, which means that in every invoice tendered for payment about 70

- 95 percent are express in foreign currency. The local currency column on its own depicts that in every invoice tendered for payment 5 to 30 percent is expressed in local currency. Column 6 is the destination of the payment column; it shows where the split currency invoices are paid. The foreign designation reveals that most of the foreign currency payments are paid into a U.S.A. or France Accounts while the local destination column is paid into a domestic bank account. Column 7 is the abstract from column 6, being the average of currency split.

For instance, a contract agreement numbered DRL-1994-2110 was signed between Chevron and Sowsco Well Services (Nig.) Limited over an oil field tagged AMAR "A". The terms of the agreement specified that 90% of the job will be invoiced in American Dollars and paid into foreign accounts while 10% will be invoiced in local currency (Naira) and paid into the local account. From the above explanation, it is evident that the greater percentages of all issued invoices are in foreign currencies between the ranges of 75% to 95% and is directly paid into foreign accounts as directed on the invoices. The foreign designated payments constitute capital flight from the economy.

Table 3 is derived from table 2. It is the average presentation of each company's currency split between the foreign and local currencies. The result shows that taking into consideration the four companies and their various currency splits, averagely 82% of all invoices are expressed in foreign currency and are paid into foreign accounts while only 18% are in local currency and paid locally.

Thus, 82% of total value created by oil servicing companies in the Nigerian Oil sector is transferred and paid into foreign accounts: This constitutes capital flight from the Nigerian Oil sector. The analysis above reveals that foreign currency payments into a foreign account constitute capital flight from the domestic economy. The invoices are paid based on the standard instruction on the invoices specifying the foreign account to be paid into. These instructions are carried out through wire transfers denying the domestic economy of the advantage of circulating the funds within the economy.

From the investigation, it was noticed that the local currency portion of the invoices paid into the domestic accounts are not enough to meet the running expenses of the company, hence the need for frequent requests for funds to be transferred into the company local account as reflected in the bank states during the examination.

To arrive at a clearer evidence of capital flight, it is imperative to rely on shell publications of its production quota and cost of production. This publication gives details of its production from 1975 to 2011 and its cost of production. See table 4 below

In order to present a vivid evidence of the magnitude of capital flight from the Nigeria oil sector, it is necessary to analyze Shell publications on its production quota and cost covering 1975 to 2011; see table 4. The table outlined Shell's volume of output. The cost of operations, Turnover, Profit after tax, foreign trade, and domestic payments. Thus, applying the 82% on Shell production quota and cost gives a clear evidence of the magnitude of capital flight from Shell operation. The outcome is shown

Table 4 shows the evidence of capital flight from shell operation between 1975 and 2011. In 1995 for instance, out of a total profit of \$1,721,100,000:00, \$1,411,300,000:00 (representing 82% of the total profit) was transferred out of the economy by way of capital flight while only \$309,800,000 representing 18% of total profit was retained within the economy while in 2011 out of the total profit of \$437,160,549.2, \$322,580,329.1 representing 82% of the total profit was transferred out of the domestic economy to the parent company abroad, leaving \$114,580,220.1 representing 18% of total profit within the economy.

This then leads to a generalization that foreign companies repatriate most, if not all their profits, thus operating at cost with no retention within the economy of their working capital. With the free nature of wire transfers, very insignificant portion of their wealth are left to the banking sector of the Nigerian economy. The rest is transferred out once the transactions are completed, leaving the economy with no stimulant for development.

Based on the above analysis, it is hard for an economy to develop when the values created within the system are transferred out. The multiplier effect of the value created is not felt within the system but outside the system. The backward and forward integration effects are restricted within the domestic system but are mostly felt in foreign economies in the form of a high influx of foreign exchange, it makes the foreign currency of the recipient country stronger while the domestic currency becomes weaker, employment generation are most felt outside than within. All these are the adverse effects of capital flight from the Nigeria economy.

In the course of the study, it was also revealed that the capital transfers from the country is not subject to any form of control or scrutiny. The instructions as directed on the invoices are simply carried out in the absence of any regulatory body. The Central Bank and the Federal Ministry of Finance are not part of the process and cannot as a matter of certainty account

for the capital outflow of this country. This leads further to discover that the central bank and the ministry of finance had no policy guideline on capital remittance from the economy. What is in effect as a matter of fact, is invested in the economy and repatriate as much as you can. No control of any kind. The effect of this practice is that it constitutes a leakage from the income stream of the system. It's a withdrawal with a dampening effect on money and product markets, thus affecting the general equilibrium of the Nigerian economy. In the money market, capital flight acts as a medium of reduction in money supply and at the same time raising interest rate within the system while investment level falls. A fall in investment level creates a spiral effect in the economy by way of low output, low employment, low aggregate savings, and capital deficiency. On the other hand, capital flight affects Nigerian product market via aggregate demand. These pulls from the system shrink aggregate demand and hence, aggregate output and employment.

The effect of capital flight on the general equilibrium of the economy traps the economy in the vicious circle of poverty; create a negative and distortionary impact on the system. Most analysts have also attributed sluggish growth and persistent balance of payments deficit in most developing countries including Nigeria, despite private foreign transfers and long-term capital inflows, to capital flight. Thus, for effective evaluation of the effect of capital flight in the Nigerian economy, it is worthy to analyze its specific effect with respect to foreign exchange availability, external borrowing and debt profile, domestic interest rate and investment, the value of the Naira, and capacity utilization of the economy.

### **Capital Flight and the Naira Value**

The effect of capital flight on the Nigerian economy came to bear in the 80's with the deregulation of the economy. This period also marks the beginning of the depreciating trend of the Naira. The reason for the upsurge in rate (Naira value) was that foreign currencies were scarce and dealers, both in AFEM (Autonomous Foreign Exchange Market) and parallel Market, had to jerk their rates due to unusually high demand from their customers (Uma, 1998). These problems of scarce foreign exchange coupled with the excess demand of foreign exchange are linked to the menace of capital flight where both corporate and individual citizens are in the obvious practice of transferring their financial assets to foreign banks.

From the supply side of the foreign exchange, it is unimaginable to believe that the Nigerian economy will ever have sufficient foreign exchange to feed its demand where billions of dollars are wired out of the economy on a daily basis. The multinational oil companies are having a field day repatriating their profit in billions each day, import all sorts of inputs unchecked even those that can be produced domestically, they embark on artificial transactions and transfer pricing practices of siphoning billions from the economy. These transactions in whatever coloration it may be are all capital flight in disguise. It reduces the foreign exchange supply of the economy, thus having a negative impact on the Naira value. According to World Bank Statement, the extent of leakages in the Nigerian financial system is estimated at \$4 billion annually through capital flight. A substantial part of the leakage goes through the international money transfer network. The transfers are through Western Union, Vigo, Money gram, as well as individual bank transfers (The Post Express, May 8, 2002). Base on this revelation, it is hard if not impossible to boost the domestic supply of foreign exchange when billions of dollars

are drained from the system through the unchecked capital flight.

On the demand side of the foreign exchange, excess demand has been the trend since 1986 (deregulation of the economy). The excess demand made way for speculative buying that led to the drop in Naira value. The Central Bank of Nigeria (CBN), while admitting that it cannot realistically meet the foreign currency demands of the public, argues that there is the necessity to exercise caution in the management of the demand side of the foreign exchange in order to stem the importation of irrelevance. The bank (CBN) admitted that importers misutilized the foreign exchange receipts most of the time, thus substituting real economic imports for fast money-spinning commercial transactions (Uma, 1998). The excess and irrelevant demand of the so call importers is an avenue of embarking on capital flight after exhausting the quantity in the parallel market, masquerade themselves as an importer to penetrate the official market for more purchase of the few available foreign exchange. This unguided import disguising channel of capital flight is the main reason behind the excess demand of foreign exchange.

In summary, the effect of capital flight on both sides of supply and demand of foreign exchange, it is revealed that the capital flight deflected sources of foreign exchange and capital flight stimulated excess demand of foreign exchange creates a wide foreign exchange gap in the system where demand exceed supply. Thus, resulting into speculative buying as Naira depreciates in value.

#### **Capital Flight and Foreign Exchange Availability and Capacity Utilization of the Economy**

Capital flight is simply defined as de-capitalization of an economy; an act where valuable productive financial resources are Tran-bordered to foreign bank accounts. These are not affected with local currency, but with hard currency mopped out of the domestic economy for onward transmission across the borders. These acts further strangle the economy already starved of foreign exchange.

It is a fact that the Nigerian oil sector and the economy at large is founded on a capital flight driven industrial structure where high foreign exchange resources are required for effective functioning of the system. Thus, the higher the foreign input requirement, the higher the foreign exchange needed to run the system. For this to happen, the domestic productive resource has to be mobilized for transaction outside the economy coupled with all the manipulations of fake transaction embodied in them. This constitutes capital flight.

The consequences of a shortage of foreign exchange as a result of capital flight in Nigeria economy are enormous such that it imposes constraints to the economic growth and development. The non-availability of foreign exchange impedes importation of spare parts and other relevant inputs for the smooth operation of the system. Resultantly, it leads to a cut in production output or even outright closure of industries. The impact is reflected in the low capacity utilization of the economy, according to manufacturing Association of Nigeria that the capacity utilization of the economy is about 30%. The reason advanced by the association is a shortage of foreign exchange availability caused by speculative buyers with the sole aim of transferring their assets to foreign accounts.

#### **Capital flight and Transfer Pricing**

Multinational corporations are more often than not linked to the problem of transfer pricing. Commercial transactions between

subsidiaries of a multinational group may not be subjected to the market forces shaping relations as between two independent companies. Transfer prices may diverge from market prices for reasons of financial policy, or to minimize tax. Thus, transfer pricing is often the most common medium where the Multinational Corporation transfers capital disgustingly from the resident economy out. This artificial transaction is capital flight because it's aimed at increasing the cost of the subsidiary companies in the host country while increasing profit in the parent company overseas (Ajayi, 1997).

#### **Capital Flight, Interest Rate, Investment and Employment Level.**

According to Ajayi (1997), Capital flight is seen as a withdrawal from the income stream of the economy, hence limiting the money creation ability within the system. This withdrawal in the form of fund transfer affects both money supply and interest rate regime within the economy. A reduction in the money supply lead to a high-interest rate and a fall in investment, capital formation within the system reduces national output drops, output and per capita income also decreases. Since the productivity potential of the economy reduces, the problem of inflation will increase in magnitude, the balance of payment problem will become prominent, investment in capital equipment and employment opportunities will equally drop, thus leading to vicious cycles of poverty. Thus, a fall in the money supply through a capital flight of investible funds from the system creates chain effects in the system such that interest rate increases, investment level falls, output falls, and employment level also drops. These finally lead to a contraction in the economy.

#### **Capital Flight, External Borrowing and Debt Crisis**

It is a fact that external borrowing and debt crisis are two fundamental problems confronting the Nigerian economy. Various studies conducted on the issue reveal a positive correlation between capital flight and external borrowing. Capital flight from Nigeria relative to external borrowing is equivalent to 91%. It connotes that in every one dollar secured as loan 91 cents are re-exported as capital flight from the system. Ajayi (1997) characterizes capital flight and external borrowing as "twin problems". Research has shown that "countries that exhibit the greatest capital flight often are also more highly indebted". These findings are consistent with the hypothesis that capital flight and external debt are closely "inter-twin". Countries like Nigeria, Rwanda, Sudan, Kenya, Brazil, Mexico, and Argentina are in consonance with this hypothesis.

Ajayi (1997) reveals that high capital flight originates the need for external borrowing to fill the foreign exchange and saving gaps. Thus, the moment the foreign capital is secured in the form of loan, grants even direct investment into the recipient economy also act as the beginning of a the second round of re-channeling back of the funds to the lender in the form of loan conditionalities attached, or as a result of servicing of an alien industrial system witnessed in Nigeria. This practice deprives the recipient economy of the needed foreign exchange for development. Rather, they are saddled with the problem of mounting external debt. For instance, the Nigerian external debt rose by 700 percent from 13.5 billion in 1980 to 28 billion in 2000 when external borrowing in the same period is equally very high. This phenomenon is attributed to the menace of capital flight as described by Ajayi (1997) as twin

problem - the higher the capital flight, the higher the debt burden.

This table shows that countries with higher debt figure also experience high capital flight. Nigeria has debt stock of US\$ 31,406.6 million in 1996 and net external assets (Real capital flight minus debt stock of US\$ 85,355.3 million and cumulative capital flight (with interest) minus debt stock of US\$ 98,254.2 million).

Net external assets are defined as cumulative capital flight minus external debt. When net external assets are positive the exist capital flight but the country is a net creditor and vice versa.

Lensink, Hermes and Muninde (1998), estimated capital flight from six countries (Congo-Zaire, Cote d' Ivoire, Nigeria, Sudan, Tanzania and Uganda) over the periods 1976 to 1989. This estimate again indicated that capital light from Sub-Saharan African countries may seem small compared to that of Latin American countries, but the burden of capital flight (as a percentage of GDP/external debt) is higher, 61% of the sub-Saharan countries compared to 22% in Latin America. The economic analysis to the determinant of capital flight indicates that the most important explanatory variable is a public external borrowing of each dollar of public or publicly guaranteed long-term borrowing 75% - 90% appear to be re-exported as capital flight.

African experience indicates that study of capital flight from severely indebted low-income countries in sub-Saharan African over the period 1980-1991, reveals that cumulative capital flight within the period averaged 40% of external debt for 18-country sampled, and that the ratio was as high as 94% for Nigeria and Rwanda, 74% for Kenya and 60% for Sudan (Ajayi, 1997). From this experience, those countries that exhibit the greatest capital flight often are also the most highly indebted. Ajayi characterizes these as "twin problem". Ajayi uses trading-partner data comparison to estimate the net effect of trade misinvoicing, which can be added to capital flight to yield an adjusted measure. This results in both upward and downward adjustments of capital flight estimates, depending on whether export under-invoicing and import over-invoicing (both of which are common mechanisms of capital flight) outweigh import under-invoicing (that is, pure or technical smuggling to evade customs duties and restrictions) in the country in question.

The experience of South Africa (1970 to 1988) reveals that capital flight estimate is between \$12 billion and \$23 billion, depending on the measure used (Ajayi and Khan, 2000). They pointed out that these amounts are large from all international standard and that during the late 70's capital flight from South Africa exceeded that from Argentina, Brazil, or the Philippines.

The Kazakhstan experience reveals that the oil-rich economy is disastrously cash poor as a result of capital flight. According to Bruce Pannier (2001), the economy is experiencing a serious problem of vanishing cash where as much as 40 percent of Kazakhstan's gross domestic product is in illegal circulation outside the country-smuggled out by wealthy business and others looking to secure their cash abroad. In Bruce Pannier's estimate, at least \$1 billion and possibly much more of Kazakhstan's cash are currently in western banks. In his view, capital flight creates a distortionary effect on the economy in the sense that the lifeline of the economy (invisible capital) is being leaked out of the domestic economy such that the multiplier effect of expanding the real sector is experienced in the recipient economy. Thus, capital flight is a disastrous leakage from the domestic economy.

The United Nation Economic Commission for Africa (ECA) declared openly that "Capital held by Africans overseas is

equivalent to 39 percent of gross domestic product (GDP) compared to six percent for Asian countries". ECA states that "if all the capital kept by Africans overseas are repatriated, the continent would move halfway towards meeting it is an external resource requirement. The report reveals that between 1982 and 1991, Capital flight from severely indebted low-income countries in Sub-Saharan African was about US\$22 billion, equivalent to about half the external resources required to steer development. This depicts that productive financial resources meant to develop and alleviate the poor masses of African countries are staged in foreign banks. These billions of dollars in foreign economies dampen the growth potential of the developing countries. Apart from its dampening effect, it continues to act as a drainage channel where more billion still find their way out in the form of interest payment on unredeemed loans from foreign banks. This irony of demanding interest on our stolen capital by foreign banks is still an issue to be addressed internationally.

The body (ECA) also draws the attention of member countries to the fact that international donors are equally worried by the growing lack of confidence of Africans to invest in Africa as shown in the figure on a Capital flight from the continent. It follows that "if Africans don't seem to have confidence in their economies by transferring the much-needed resources out for security, they should not on the other hand expect non-African to do what they cannot do for themselves" (a statement credited to Eveline Herfakens, Dutch minister for Development cooperation during the ECA conference - 1999). This brings to bear that Capital Flight is a measuring parameter of the lost of confidence in an economy by its residents and a determining factor for further foreign aid and assistance from the international community.

Despite all the explanation on the various causes, nature, and measurement of capital flight enumerated in economic literature little or no attention had been drawn to the fundamental lopsided industrial structure of most under developed countries. It reveals a gap where relevant literature has failed to capture capital flight from structural defects of most developing economies as a result of historical (colonial) antecedents. This is a situation where the mainstay of the economy was laid defectively in order to satisfy the outside world than the domestic economy. Thus, this results to instituting an industrial foundation that is capital intensive in a labor surplus economy. Both the industrial and agricultural sectors were laid with the obvious manifestation of the present day capital flight menace. Hence, the capital flight should be viewed strongly from fundamental structural defects of most underdeveloped economies which by its very nature are capital flight driven.

## METHODOLOGY

The methodology of the study is that of descriptive analysis using tables, and simple percentages in analyzing the financial data obtained from both the primary and secondary sources for the period under study. The primary data were obtained from the Oil Companies surveyed while the secondary data were obtained from the Central Bank of Nigeria statistical bulletins, various issues. The analysis was done to show how much money was repatriated and how much was left in the domestic economy. Specifically, data on repatriation of finances (capital flight) from the subsidiary companies in Nigeria to their parent companies abroad were obtained from the oil companies surveyed.

## SUMMARY AND CONCLUDING REMARKS

### *Summary of Findings*

Capital flight in Nigeria is mainly attributed to the structural defect of the nation's industrial base. Import substituting industrial strategy laid the foundation of a foreign industrial structure in the Nigerian economy that requires foreign inputs and technologies for its effectiveness. This structure by its very nature is capital flight driven. Other causes of capital flight in Nigeria are a high risk within the economy, loss of confidence in the system, frequent change in government policies and fear of losing the value of an asset as a result of the depreciating value of the Naira.

The evidence presented in this paper reveals with core facts the root of the problem as it has affected the economy over the years:

(i) Dual currency invoicing had been observed to be the general practice within the Nigerian oil sector. This practice is a situation where invoices for payment are split into foreign and local currency portions. The foreign currency split is directed to be paid into a foreign account while the local currency portions are paid domestically;

(ii) It was discovered that foreign currency split fell within the range of 70 to 95 percent of all invoices tendered for payment. On the average, 82 percent of all invoices were denominated in foreign currency and paid internationally. On the other hand, local denominated invoices fell between 5 to 30 percent of all invoices tendered for payment. Averagely, only 18 percent is denominated in Naira and paid into domestic bank accounts;

(iii) The transfers of the foreign denominated invoices are paid internationally as directed in most cases on the invoices without passing through the Central Bank of Federal Ministry of Finance. This reveals that both the monetary and fiscal authorities lack comprehensive financial guideline for the remittance of funds from the economy;

(iv) This paper also discovered that foreign companies at any given point in time operate their accounts within the economy at a "near zero" position. They transfer their foreign currency payment to their foreign account such that the local currency payment is not enough to meet the financial commitment of the company. This financial position at each time necessitated the frequent cash calls from their foreign accounts to beef-up their local account to meet any contingency expenditure. Their books of accounts reveal that some foreign firms call up to three or four times within a month for funds transfer from abroad;

(v) It is also staggering to note that local company's participation in the oil sector is less than 5 percent. It shows then that, 95% of functional companies in the sector are foreign companies.

### *Based on our findings, we recommend that*

(i) National Corporation for Foreign Investment, Input, and Technology of Nigeria should be established. This body will be saddled with the responsibility of harnessing all foreign investment inflows and to evolve an industrial culture for the country. Its functions will include: registering of all foreign investment; scrutinize the type of technology to be introduced into the country and its merits; scrutinize their manpower and expatriate quota requirement; examine all foreign inputs into the country. This will checkmate all manner of importation when they can be sourced locally; both the social cost and benefit must be analyzed for each of the incoming investors.

Backward and forward integration effect must be clearly outlined and evaluated; Nigerians must be employed and trained with the sole objective of replacing the foreigners. This body is obviously necessary if our development potentials are to be fully harnessed for national development.

The era of haphazard investment should be discarded. A situation where a foreign company comes into the country with almost all its principal staff being foreigners includes both administrative and account staffs should be stopped.

The organizational structure (of the proposed board) should be fashioned in a way that each sector of the economy constitutes a department headed by indigenous specialists in the field for effective scrutiny of all foreign investment in the sector.

(ii) Effort should be made toward indigenizing of the Nigerian oil sector in terms of manpower, technology, and other relevant inputs in order to control capital flight.

(iii) Contract policy should be formalized with some contract reserve for the local companies in the area of their technical competence. The policy of foreign technical pattern for local companies should be scrapped or at least not compulsory.

(iv) Locally manufactured goods must be patronized as inputs as against imported inputs. Some of these local spare parts are proven to be of higher quality than the imported ones. The government should put its policy right in this area in order to control the unnecessary importation and also curb capital flight. The government should go a step further by the outright banning of some foreign inputs to the country where there are local companies should be given this opportunity to improve on their product. Bear in mind that these foreign companies have improved on their output over the years (some over 50 - 100 years) of trial and error.

(v) On the grounds of insecurity and risk (causes of capital flight), the government should promulgate a law to safeguard foreign capital inflow. There should be legislation guaranteeing the safety of foreign capital, even in the face of bank failure, change in government policy or change in government. These safety legislations will act as a booster needed to build confidence in the Nigerian economy. Once this confidence is built the "mad rush" of transferring capital/profit from the domestic economy will be reduced and thus a reduction in capital flight.

(vi) The economy grows when there are reinvestments of value created. There should be a re-investment incentive (law) for foreigners who may wish to re-inject their profit into the economy. For this re-investment incentive to be utilized by foreigners, there must be substantial proves that the invested capital is a product of an earlier investment in the economy. The re-investment incentive may be in the form of tax rate reduction. Tax holiday, reduction of property rate, and free donation of an industrial site that must be developed immediately. These incentives will rather create a more friendly investment climate and the need to re-invest in the economy than embarking on a capital flight. Note that the aim of this development strategy is not directed toward government revenue rather its purely to capture the backward-forward integration effect of earlier foreign investment. This resultantly will create more economic activities, more tax base, and more revenue in the future.

(vii) Furthermore, the government should formulate a more comprehensive remittance policy for the country. A detailed policy guideline should be released to guide capital transfers from the economy through the Central Bank or any other designated channel. This stipulated channel will furnish the economic planning experts with the necessary statistical

information concerning the magnitude of capital outflows, the causes of the outflow and possible remedies.

### CONCLUDING REMARKS

In conclusion, for a capital flight to be stemmed, ethnic, religious, and political crises must be controlled and reduce to the barest minimum. It's obvious that crises ridden

societies/economies encourages transfers of valuable assets. Thus, for the Nigerian economy to experience a reduction of capital flight, inter-communal and ethnic crises must be put under control, economic unrests in the south-south region emanating from resources control saga must be settled. Sharia crises and Boko Haram bombing must also be brought under control.

**Table 4:** Shell Operation (1975 - 2011)

Year	Turnover(\$ million)	Cost of Production (\$ million)	Profit (\$ million) (2 - 3)	82% Foreign Transfer (Applying 82% on 4)	18% Domestic Payment (Applying 18% On 4)
1975	2409.5	688.4	1721.1	1411.3	309.4
1980	2829.4	744.9	2084.5	1709.3	375.2
1985	1842.7	462.1	1380.6	1132.1	248.5
1990	2511.0	731.8	1779.2	1458.9	320.3
1991	2147.8	650.0	2082.8	1707.9	374.9
1992	2083.2	746.9	1336.3	1095.8	240.5
1993	1790.4	633.2	1156.8	948.6	208.2
1994	469.8	812.0	-342.2	-280.6	-616
1995	1447.8	730.7	716.8	588.0	128.8
1996	1236	725.3	510.5	418.6	91.9
1997	1051.2	756.0	295.1	242.0	53.1
1998	1245	747.3	507.5	416.2	91.3
1999	1177.4	739.5	437.7	358.9	78.8
2000	1157.9	744.3	413.4	371.4	42.1
2001	1193.4	740.4	452.9	371.4	81.5
2002	1176.2	741.4	434.7	356.5	78.2
2003	1175.8	742.0	433.7	355.6	78.0
2004	1181.8	741.3	440.4	361.2	79.3
2005	1177.9	741.6	436.3	357.7	78.5
2006	1178.5	741.6	436.8	358.2	78.6
2007	1179.4	741.5	437.8	359.0	78.8
2008	1178.6	741.6	436.9	358.3	78.6.
2009	1178.8	741.6	437.2	358.5	78.7
2010	1178.9	741.6	437.3	250.9	186.4
2011	1178.8	741.6	437.2	322.6	114.6

Sources: **CBN Publication No 14, 8th October 1996 and Shell Publications 2014**

**Table 5:** Evidence of Capital flight from Shell (1975 - 2011)

Year	Total Profit (\$)	Capital Flight (\$)	Domestic Payment (\$)
1975	1,721,100,000	1,411,300,000	309,800,000
1980	2,084,500,000	1,709,300,000	375,200,000
1985	1,380,600,000	1,132,100,000	248,500,000
1990	1,779,200,000	1,458,900,000	320,300,000
1991	2,082,800,000	1,707,900,000	374,900,000
1992	1,336,300,000	1,095,800,000	240,500,000
1993	1,156,800,000	948,600,000	208,200,000
1994	(342,200,000)	(280,600,000)	(61,600,000)
1995	716,866,666.7	587933333.3	128,933,333.3
1996	510522222.2	418644444.4	91,877,777.8
1997	295096296.3	241992592.6	53,103,703.4
1998	507528395.1	4161901234	91,338,271.7
1999	437715637.9	358942386.8	78,773,251.1
2000	413446776.4	371391403.7	42,055,372.7
2001	452896936.5	371391403.7	81,505,533.1
2002	434686450.2	356458497.1	78,227,953.1
2003	433676721	355630533.9	78,046,187.1
2004	440420035.9	361160144.9	79,259,891.0
2005	436261069	357749725.3	78,511,343.7
2006	436785942	358180134.7	78,605,807.3
2007	437822348.9	359030001.6	78,792,347.3
2008	436956453.3	358319959.9	78,636,493.4
2009	437188248.1	358510030.1	78,678,218.0
2010	437336946.1	250910997.3	186,425,948.8
2011	437160549.2	322580329.1	114,580,220.1

Source: Derived from Table 4 above

## REFERENCES

- Ajayi, (1997), "An Analysis of External Debt and Capital flight in the severely Indebted Low Income Countries in Sub-Sahara Africa", IMF Working Paper WP/97/68.
- Ajayi, Ibi (1992): An Economic Analysis of Capital Flight from Nigeria. World Bank Working Papers No.993
- Ajayi, Ibi and Moshin Khan (2000): External Debt and Capital Flight in Sub-Saharan Africa.
- Awung, W. J. (1995), "An Economic Analysis of Capital Flight in Cameroun" Final Report the African Economic Research Consortium, Nairobi.
- Boyce, James K. and Leonce Ndikumana (2001): "is Africa a Net Creditor? New Estimates of Capital Flight from severely Indebted Sub-Sahara African Countries, 1970 - 1996", University of Massachusetts.
- Central Bank of Nigerian Publication No. 14, 8th October, 1996.
- Claessens, S. and D. Naude (1993): "Recent Estimates of Capital Flight" Policy Research Working Papers WPS 1186
- Cuddington, J. T. (1986), "Capital Flight: Estimate, Issues and Explanations" Princeton Studies in International Finance, No. 58 (Princeton, N. J: Princeton University).

- Cumby, R. and R. M. Levic (1987: "On the Definition and Magnitude of Recent Capital Flight" Working Paper No.2275. National Institute of Economic Research.
- Dooley, M. (1986), "Country - Specific Risk Premium Capital Flight, and Net Investment Income Payments in Selected Development Countries" Mimeo, Washington D. C.: International Monetary Fund.
- Dooley, Michael (1998): "Buy-Backs and the Market Valuation of External Debt" IMF Staff Papers. Washington, DC.
- Duwendy, D. (1989), "Capital Flight from Developing Countries", Development Co-operations (3).
- Emeagwali, Philip (2001): "The Flight of Financial Capital from African", Interview Invoice of America, March 2000".
- Erbe, S. (1985). The Flight of Capital from Developing Countries". Inter Economics, Nov./December
- Gulati, Sunil K. (1985): Capital Flight through Faked Invoices: 1977-1983: A Statistical Note" Columbia University, New York, NY May.
- Harbeson, John W. and Donald Rothchild (2000); African in world Politics: The African State System in Flux, 3rd Edition: West View Press, London.
- Hermes et al. (2002). Capital Flight the Ken, Issues. An Andrew Milineux and Victor Marinade (eds) Handbook of International Banking 3/6-543.
- Khan, Moshin (1989a): Capital Flight from Developing Countries" Finance and Development, March.
- Khan, Moshin and Nadeen UI Haque (1985): Foreign Borrowing and Capital Flight: A Formal Analysis" IMF Staff Papers Vol.32, No.4
- Lensink, L. Hermes, W. and Murinde, V. (2000). Capital Flight and Political Risk Journal of International Money and Finance.
- Lensink, Robert, Niels Hermes and Victor Muninde (1998); "The Effect of Financial Liberalization on Capital Flight in Africa Economies" World Development 26 (7): 1349 - 1318.
- Lessard, D. R. and J. Williamson (1987); "Capital Flight and Third World Debt": Institute for International Economics, Washington D. C.
- Morgan Guaranty Trust Company (1986); "LDC Capital Flight" World Financial Market (March, 13 - 15).
- Nyong, M. O. (2005), International Economics: Theory, Policy and Applications. Unisen Publishers, Calabar.
- Obadan M. F. (2004): Foreign Capital Flows and External Debt. Perspective on Nigeria and the LDC's Group.
- Obaseki G. (2001); "Oil Industry Operators Emphasis Importance of Local Content Development" Vanguard. Vol. 17, No. 4731, April 17, 2001.
- Obaseki, G. (2000), "Nigeria Urges for Indigenous Participation in Upstream Sector," News and Trends: Africa. Vol. 6, Issue 16 - 28/08/2001.
- Pannier, Bruce (2001); "Kazakhstan: Deputies Draft Plan to Reverse Capital flight".
- Pastor, Manuel (1990); "Capital flight from Latin America: World Development" 6th Edition; Addison Wesley Longman Limited, New York.
- Post Express, May 8, 2002. Root, R. Franklin (1994); International Trade and Investment; 6th Edition: South - Western Publishers Company, Ohio.
- Salisu M. (2005): The Role of Capital Flight and Remittances in Current Account Sustainability in Sub-Saharan Africa. Development Research Department, Africa Development Bank Tunis, Tunisia.
- Schineller, L (1997); "An Econometric Model of Capital Flight from Developing Countries"; International Financial discussion Paper No. 579 (Washington, D. C.: Board of Governors of the Federal Reserve System).
- Shapiro, Alan C. (1992); Multinational Financial Management; 4th Edition; Allyn & Bacon Publishing, Massachusetts..
- Uma, Idika Kalu (1998); Nigerian Foreign Exchange Markets: Management & Development; Spectrum Books Limited, Ibadan.
- Vanguard Newspaper, April 16, 2001.
- World bank (1985): World Development Report (Washington DC).